No. 20,981

In the

United States Court of Appeals

for the Ninth Circuit

JOHN M. ENGLAND, As Trustee of the Estate of MAHL ASSOCIATES, INC., a corporation, Bankrupt,
Plaintiff and Appellee,

vs.

ARCHIE SNIDER, individually and doing business as SNIDER CONSTRUCTION CO.,
Defendant and Appellant.

On Appeal from the United States District Court
for the Northern District of California

Reply Brief of Appellant Archie Snider Individually and Doing Business as Snider Construction Co.

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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I.

ARGUMENT

A. Introduction.

Throughout his brief plaintiff largely ignores the essential arguments advanced by defendant. In particular, plaintiff fails to answer the proposition that this Court has broad powers to review and reverse the findings of the

lower court in a case such as this. (Appt's Op.Br., p. 7.) Plaintiff also avoids defendant's contentions relative to the applicability of the doctrine of retrojection applied by the lower court. (Appt's Op.Br., p. 8.) In addition, plaintiff fails to comment upon the rule that when two equally persuasive inferences may be drawn from substantially undisputed facts, the inference upholding the transaction should be applied. (Appt's Op.Br., p. 12.) And finally, plaintiff avoids discussion of the many cases cited by defendant on the question of the necessary proof to support findings of reasonable cause to believe that insolvency exists.

Rather than discussing the issues thus raised, plaintiff's brief consists largely of a restatement of many facts and much testimony which he claims as supporting direct findings of insolvency and of actual knowledge by defendant of insolvency, neither of which, by plaintiff's own admission, did the trial court pass upon. (Re retrojection, see Appl's Br., p. 3; re actual knowledge, see Appl's Br., p. 8.)

Plaintiff's avoidance of these basic questions is significant and can only suggest that he is unable to refute defendant's argument pertaining to those questions.

Following are more specific replies to plaintiff's brief.

B. Insolvency.

Plaintiff argues that this Court is without power to overrule the lower court's finding unless it is "clearly erroneous." (Appl's Br., p. 5.) No doubt this is the general rule and it has been so recognized by defendant. (Appt's Op. Br., p. 6.) However, as pointed out in the Opening Brief, this Court's powers of review are much greater in this case because the decision below turns primarily upon inferences drawn from undisputed facts. (Appt's Op.Br., p. 7.)

Plaintiff offers no reason why that rule should not apply here.

Plaintiff says also that there was no change in the financial condition of the bankrupt between the date of transfer and date of adjudication. (Appl's Br., pp. 5-6.) The only direct evidence on this point was Mahl's testimony. The other testimony plaintiff refers to is related to times prior to the date of transfer which have no bearing on the change of condition between the two crucial dates.

Plaintiff does not refute defendant's argument (Appt's Op.Br., pp. 8-10) that the doctrine of retrojection was improperly applied by the trial court here.

Plaintiff stresses the fact that the bankrupt never received the financing it was seeking during the months in question. He states that, "If Mahl had been able to obtain such additional financing before the transfer, then perhaps it would be arguable that Mahl Associates was solvent on the date of transfer." (Appl's Br., p. 6.) This demonstrates plaintiff's misunderstanding of the requisites of insolvency in the bankruptcy sense. The additional financing, had it been obtained, would not have altered the asset-liability status of the bankrupt at all. Rather, it would merely have strengthened its working capital position because the assets and liabilities would have been both equally increased. Likewise the inability to obtain such financing did not adversely affect the asset-liability status, but merely left the bankrupt in a weak working capital position. Such has been defendant's contention from the beginning.

Plaintiff concludes this part of his argument with the assertion that it was "conclusively demonstrated" that on the date of *adjudication* (not the date of the transfer two months previously) the bankrupt had more debts than the potential assets it claimed to have as a going business.

(Appl's Br. p. 7.) The apparent net deficit upon adjudication was about $170,000. (Appl's Br., p. 6.) But if Mahl's statement of June 30, 1961, given to the California Corporations Commissioner is entitled to any credence, (Def's Exh. A), the following assets were available to the bankrupt as a going business but obviously lost or seriously impaired upon bankruptcy, as is well demonstrated by the bankrupt's schedules (see R.T. 22-25): Accounts receivable, $69,000; Notes receivable, $27,000; Advances to salesmen, $5,000; Work in process (laundries for resale), $79,000; Prepaid interest, $3,000; Notes receivable (against salesmen's commissions), $59,000; Furniture and fixtures, $6,000; Deposits $12,000; Organization expense, $1,000; and Reserves on discounted sales contracts, $8,000—total $269,000! This is not to mention the bankrupt's equity in $99,000 worth of inventory.

Contrary to the Court's decision that it was "an inescapable conclusion that the bankrupt was insolvent at the time of the transfer" (T.R. 45), the evidence fails to provide good reason to assume that there had been no substantial change in the status of the business with respect to assets and liabilities between the date of transfer and the date of filing the petition. (1 Collier, *Bankruptcy,* 1.19 [3]-[5], p. 125.)

It is most significant that plaintiff was compelled to rely on the theory of retrojection to establish insolvency because Mahl had fortuitously destroyed the books and records of the corporation after this suit was filed but before trial. (R.T. 18.) Under these circumstances, any doubt on this point should certainly be resolved in favor of defendant.

C. Reasonable Cause to Believe Insolvency.

In support of the argument that Mr. Snider had reasonable cause to believe that the bankrupt was insolvent on the

crucial date, plaintiff sets forth seven facts concerning which Mr. Snider was purportedly aware on the date of transfer. (Appl's Br., p. 9.) Upon analysis, these seven facts are but two. Most of the matters cited relate to the bankrupt's inability to meet current obligations ("Facts" Nos. 1, 2, 3 and 5), and it is conceded that Mr. Snider was aware of this. As to the alleged "cessation" of payment of rent, ("Fact" No. 4) the evidence does not support the contention. It is true that the bankrupt was chronically late in paying rent; indeed, in October it had been nineteen days late and in April twenty-three days late. (R.T. 113.) At the date of transfer only eleven days had passed since the last rent payment had been made on October 19th. This is but another example of slow payment of which Mr. Snider was already aware.

The fact that the bankrupt was unable to meet current obligations due to a poor cash position and was therefore required to sell an asset which was not in use in the conduct of its business ("Fact" No. 6), is entirely consistent with solvency.

Merely because Mr. Snider had knowledge that the bankrupt was slow in meeting its current obligations does not support a finding that the transferee had reasonable cause to believe that the bankrupt was insolvent at the time of the transfer. (Appt's Op.Br., p. 13.)

Plaintiff finally argues ("Fact" No. 7) that Mr. Snider had been informed that Mahl Associates was insolvent and therefore had actual knowledge of the fact of insolvency. Major reliance is placed on disputed evidence on this point, *which was rejected by the trial court,* in attempting to establish reasonable cause to believe that insolvency existed: once in listing the seven alleged facts giving rise to reasonable cause to believe in insolvency (Appl's Br.,

p. 9); again in discussing *I-T-E Circuit Breaker Company v. Holzman* (9th Cir. 1965) 354 F.2d 102 (Appl's Br. p. 10); and once again in distinguishing, *without other comment,* cases cited in the opening brief on this subject (Appl's Br. p. 11).

The controversial and impeached testimony by Mahl and French on that subject (Appt's Br., p. 18) was unacceptable to and disregarded by the trial court. Plaintiff concedes as much (Appl's Br., p. 8.), and the trial court did not include as a finding of fact that Mr. Snider had actual knowledge of the bankrupt's insolvency.

It is obvious then that the two (actual knowledge and reasonable cause to believe) are completely distinct tests. Plaintiff, in effect, says that Mr. Snider had reasonable cause to believe insolvency existed because he had actual knowledge of that fact, even though the trial court refused to base its decision on that fact. It must be concluded that the trial court's finding that there was reasonable cause to believe in insolvency was based on facts other than the alleged conversation in October with Mr. Snider.

Without proof of actual knowledge of insolvency plaintiff's argument on this vital question must fail. All that is left is knowledge of the slowness of the bankrupt in making payments which is manifestly not sufficient.

Plaintiff's reference to the *I-T-E Circuit Breaker* case and his attempt to distinguish defendant's cited cases are therefore unavailing. The present case has less evidence of reasonable cause to believe than the *I-T-E Circuit Breaker* case since in effect only the third element attributed by plaintiff to that case is present here, i.e., that "the transferee knew that the bankrupt was consistently delinquent in meeting its bills from the transferee." (Appl's Br., p. 10.) From the foregoing it is clear that plaintiff has

offered no basis to refute defendant's assertion that the decision of the trial court was "clearly erroneous" in finding that Mr. Snider had reasonable cause to believe that the bankrupt was insolvent on the date of the transfer.

D. Exclusion of Evidence.

The rejected evidence tendered by defendant through the witnesses Holderly and Vedovie (see Appt's Op.Br., pp. 19-20) was objected to for a variety of reasons including the ground that these witnesses were not named in the pre-trial statement. (R.T. 101.) There are two reasons why the ruling was wrong.

First, the local rules of the District Court expressly permit the use of witnesses not named in the pre-trial statement if the purpose is impeachment. (Rule 4[11].) The evidence offered through these witnesses (Appt's Op. Br., pp. 19-20), would have directly impeached Mahl's testimony that he told "most everyone who was interested" that the corporation was insolvent during the latter part of 1961 (R.T. 41.)

Furthermore, the evidence would have impeached Mahl's testimony as to when he last made applications for financing. Mahl did not testify that he was trying to get financing "up to the time he went into bankruptcy" as the lower court's comment suggests. (R.T. 104-105.) Rather it was Mr. French who made that statement in his deposition, which he contradicted at trial. (R.T. 61.) Mahl testified that he was attempting to receive financing *as late as* October or November of 1961 (R.T. 46); that *in the last quarter* he was not attempting to borrow (R.T. 85); and that *as late as* September and October he was attempting to get loans of money (R.T. 85). This evidence would have impeached Mahl's testimony in this regard, indicating that

he was applying for credit as late as November 15, 1961. (R.T. 104.)

But more important, the local rules do not exclude direct evidence from witnesses who are not listed in the pre-trial statements. Discretion as to admissability is vested under the rules with the trial court. Here, the lower court based its ruling on the ground that the evidence was "purely hearsay"—not on the ground that the rules excluded the evidence. (R.T. 105, 122.) The question, then, is whether the evidence was properly excluded as being hearsay. Based upon a recent decision of this Court (cited by the court below) the answer must be answered in the negative.

Under the holding of *I-T-E Circuit Breaker Company v. Holzman* (9th Cir. 1965) 354 F.2d 102 (T.R. 47; Appt's Op.Br., p. 19; Appl's Br., p. 10) Mr. Snider was chargeable with notice of all facts which a reasonably diligent inquiry by himself would have disclosed. In the present case the trial court in effect said that a reasonably diligent inquiry by Mr. Snider would have revealed the alleged insolvency. The evidence barred related directly to this question. It was not offered for the *truth* of the statements as to Mahl Associates' financial condition, but simply to show the *effect* it would have had upon one making inquiry. Such is not hearsay. Fed.R.Civ.P. 43(a), Witkin, California Evidence (2d ed. 1966), §§ 468, 470, and cases cited therein.

II.

CONCLUSION

The decision below was wrong and must be reversed.

Dated: December 30, 1966.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN F. TAYLOR

Attorney for Appellant